C.D. Howe Institute
Backgrounder

www.cdhowe.org

No. 66, February 2003

A New Agenda for Strengthening Canada's Aboriginal Population:

Individual Treaty Benefits, Reduced Transfers to Bands and Own-Source Taxation

John Richards

The Backgrounder in Brief

Most Canadians understand that aboriginal governments should be taken seriously as part of the country's political fabric. For their part, many Indians want to live a more traditional life on a well-run reserve, while others prefer life off the reserve. Sound economic policies could give individual Indians more flexibility in their choice of where to live and give those who stay on-reserve more direct influence over their chiefs and councils. It is in the interest of all Canadians to make sure the federal government puts these policies into action.

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Quotation with appropriate credit is permissible.

$5.00; ISBN 0-88806-582-5;
ISSN 1499-7983 (print); ISSN 1499-7991 (online)

103-02886/

My intent in writing this *Backgrounder* is to make the case for diverting a significant share of treaty benefits from band councils to individual Indians, and for introducing on-reserve taxation by band councils. As will become apparent, the two proposals are intimately linked.

Over the last three decades, the rationale underlying Canada's aboriginal policy has changed radically. To simplify only a little: Underlying the 1969 White Paper tabled in Parliament by Pierre Trudeau and his Indian Affairs minister Jean Chrétien is an unquestioning faith in liberal individualism, a belief in the equality of all Canadians as individuals and a denial that the cultural differences between aboriginal and nonaboriginal people had any political significance. On the other hand, underlying the 1996 report of the Royal Commission on Aboriginal Peoples (RCAP) is an equally strong faith in cultural anthropology — a belief that culture is the most significant of human characteristics and that, since the cultures of aboriginals differ significantly from those of the settlers who expropriated the continent, the two groups share little of substance. According to the RCAP commissioners, "Aboriginal people's sense of confidence and well-being as individuals remains tied to the strength of their nations. Only as members of restored nations can they reach their potential in the twenty-first century" (Canada, RCAP 1996, *x–xi*).

For authors of the White Paper, racism meant policies that treated individual aboriginals as bearers of fewer citizenship rights than other Canadians. For RCAP commissioners, it meant policies that abet aboriginal assimilation, that fail to preserve and develop aboriginal "nations." The central policy problem addressed in this more recent report is not one of assuring equal individual rights and obligations for all Canadians, but of interpreting Indian treaty rights broadly, giving band governments scope to act outside the legal and prolitical constraints imposed by nonaboriginal Canadians on nonaboriginal governments.

As it should, the recent Speech from the Throne devoted many paragraphs to the importance of ending aboriginal poverty. Few social issues are more important in contemporary Canada. But the problems exceed the reach of either the liberal political ideas of the 1960s or the current wisdom rooted in cultural anthropology. I make the case here for applying a little economics to the issue.

An immediate caveat. Economics too has a limited ability to shed light on aboriginal problems; it is a necessary, but not sufficient, perspective to bring to bear.

From White Paper to "Governance Initiative"

The 1969 White Paper was an honourable attempt to end formal racial discrimination, but it attempted too radical a rupture with the past. Its focus was on the individual. But the communal features of culture are more important to aboriginals than, in general, are analogous cultural features to nonaboriginals. For six centuries, settlers arriving on this continent have recognized Indian

I thank Henry Milner, Finn Poschmann, Jon Kesselman, and Bill Robson for thoughtful comments on earlier drafts of this paper. In an important manuscript, Jean Allard (2002) advances ideas similar to mine. The usual disclaimers apply: the above are not responsible for any errors, and they do not necessarily agree with my conclusions.

governments separate from their own. Indian leaders denounced and successfully blocked implementation of the assimilationist ideals underpinning the White Paper.

By the late 1990s, however, the pendulum had swung too far the other way. The fundamental flaw of Canadian Aboriginal policy in the RCAP era is that it ignores diversity among aboriginals. Undeniably, many want a communal lifestyle, respectful of traditions; also undeniably, many others want to be part of urban, industrial Canada and to enjoy the higher incomes realizable off-reserve.[1]

A second weakness lies in the incentives created by Ottawa for band councils to indulge corrupt fiscal practices. At the time of the White Paper, Ottawa spent relatively little on transfers to band governments. The total 1969/70 budget of the Department of Indian Affairs and Northern Development amounted to $347 million, including $160 million in the Indian and Eskimo Affairs Branch (Canada, Indian Affairs 1972). In 2000/01 the department spent $5.1 billion, of which $4.1 billion was in the form of transfers to bands (Canada 2001b).[2] Ottawa now spends vastly increased sums — even allowing for inflation — on transfers to bands to provide services.

As with all federal spending programs, transfers to band councils are subject to audits. Even a cursory reading of the many reports on the subject by the Auditor General makes it obvious, however, that neither the federal government (representing Canadian taxpayers) nor individual band members have been able to impose adequate accountability regarding the spending of the transfer money by band councils.[3]

Neither the federal government nor individual band members impose adequate accountability on spending.

A survey of band governance issues was recently published by Jean Allard, a former Manitoba politician who was a member of Ed Schreyer's provincial government. The post-1969 expansion transfers to band councils has, Allard concludes, created profound problems:

> ... chiefs and [band] councils today have a great deal of money to work with. The funds for housing, welfare, education and other such services flow through their hands. Since there is no real separation between politics and administration on reserves, everything on a reserve that is in any way related to band administration is politicized. Whoever is elected is in control of just about everything on a reserve. The result is elections coloured by bitter rivalries and ugly disputes.

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1 In a forthcoming *Commentary*, Drost and Richards review evidence, drawn from the 1996 census, about incomes among off- and on-reserve aboriginals. The median 1995 income among the on-reserve-identity aboriginal population was $8,900; the analogous figure for off-reserve aboriginals was $12,400 — 39 percent higher (yet still far below $19,400, the 1995 median among nonaboriginal Canadians).

2 These figures are illustrative, not definitive. The 1969/70 data are not disaggregated into transfers to bands vs. centrally controlled spending. Furthermore, both in 1969/70 and 2000/01, Ottawa spent money on aboriginal programs via ministries other than Indian Affairs. The second most important ministry in this regard is Health Canada, which, in 2000/01, spent $1.4 billion in the First Nations and Inuit Health Branch.

3 For an example of the Auditor General's frustrations, see the report on on-reserve education (Canada 2000). Women's groups figure prominently among the critics of band governance. Allard (2002, chap.6) describes, for example, the work of Leona Freed and the First Nations Accountability Coalition. For journalists' assessments of band corruption, see, for example, Cheney (1998) and Brooke (2001).

Box 1: The First Nations Government Initiative

The First Nations Governance Act

Tabled in June 2002 by the Minister of Indian and Northern Affairs, this act sets out the powers of band councils, much as provincial legislation defines the powers of municipal governments. Its provisions can be summarized as follows:

- The means for selecting the band chief, whether by election or by some traditional means, is to be codified in writing and be ratified by all eligible voters.
- Band-designed codes must be in writing and must include an appeal process against band decisions. They must specify the size and composition of the council, the mode of selection of band councillors (a majority of whom must be elected), and the term of office for councillors, including grounds for removal.
- The codes must specify who can nominate, who can run for council, and who can vote; voting is not to be restricted to band members living on-reserve. Codes must define corrupt electoral practices.
- All bands must maintain the basic accountability principles of transparency, disclosure and redress. Band financial statements must be audited by an independent auditor and made publicly available.
- Individual band members will henceforth obtain greater access to financial information, such as audited financial statements, annual expenditure plans and details of remuneration and expenses paid to council members.
- The matters over which band councils may legislate is specified.
- Band councils are henceforth subject to provisions of the Canadian *Human Rights Act*.

The First Nations Fiscal and Statistical Management Act

In August 2002, the Minister announced consultations with bands on this act which is intended to improve the quality of band governance via four institutions as follows:

- The First Nations Finance Authority (FNFA) will allow bands acting collectively to raise long-term private capital to finance infrastructure.
- The First Nations Financial Management Board is to act as a consulting service for the FNFA.
- The First Nations Statistical Institute will assist band councils with their statistical needs, and advise Statistics Canada.
- The First Nations Tax Commission will advise on band real property tax bylaws and mediate between band and ratepayer interests. The intent here is to resolve problems arising from band taxation of nonmembers. (See Kesselman 2000.)

Sources:

Information in this box was drawn in October 2002 from the Web site maintained by the Department of Indian Affairs: www.ainc-inac.gc.ca, including the First Nations Governance site, www.gng-gpn.gc.ca; www.fntc.ca; www.fnfi.ca.

> Reserves are one-dimensional systems. Elsewhere in Canadian society, multiple voices act as checks and balances on each other.... There are no such "other voices" on reserves, leaving the single dimension of politics in which to work out solutions to social, economic and political problems....
>
> On the reserves, the chiefs and councils who played ball with Indian Affairs obtained [as years passed] more and more control over budgets and services. But the checks and balances to keep the chiefs and councils on the straight and narrow were not there. *People could not pick up and go to a band with a better administration.* And since the money funding the band did not come from band members, they had no means to hold their chiefs and councils accountable. (Allard 2002, 128, 131) [*Emphasis added.*]

The federal Cabinet has been obliged to acknowledge the severity of band governance problems. In 2001, Indian Affairs launched a high-profile initiative to tackle them. Two major pieces of legislation related to the issue have been tabled in Parliament: the *First Nations Governance Act* and the *First Nations Fiscal and Statistical Management Act* (see Box 1). To date, neither has become law.

The strategy underlying the *First Nations Governance Act* is to strengthen the probability of open and fair elections for band councils, thereby giving ordinary band members a better chance of holding their respective councils to account. The Assembly of First Nations (AFN), the major national association representing band chiefs and councils, has vociferously opposed this statute as an infringement on the principle of self-government. The second piece of legislation, the *First Nations Fiscal and Statistical Management Act*, has been drafted in conjunction with the chiefs concerned. The hope is that it will improve band governance by ensuring councils have access to adequate professional advice.

Economic Incentives: The Missing Link

The missing link in the federal band governance initiative has been consideration of economic incentives. Here I emphasize two dimensions: the locational neutrality of fiscal transfers, and the issue of own-source taxation.[4]

Locational Neutrality in Fiscal Transfers

Allard (2002, 118) contrasts the present means of choosing band leaders unfavourably with the customs of the nineteenth century: "A chief did not order his people to follow his wishes. He advised them of his plans, and if people disagreed with him, they were free to make their own decisions about whether to

4 Another dimension to any discussion of on-reserve economic incentives is the appropriate role of private property instruments in an environment where the majority favour, in general, retention of collective property. In a recent survey of this subject, Tom Flanagan and Christopher Alcantara (2002, 16) conclude: "Private property rights on reserves are a useful instrument but not a magic wand. Even when progress is made, many problems remain because of the small size and relative poverty of most Indian communities." On a typical reserve, the inefficiencies induced by present federal transfer policies probably far exceed the inefficiencies resulting from the absence of private property instruments.

follow him or join a different tribe. It was an effective check and balance on the power of leaders."

An important tradition in economic analysis views local governments (such as municipalities or cantons/provinces/states) as competitors, attracting mobile residents and retaining established residents by offering popular combinations of public services and required taxes.[5] In a democracy, residents can effect changes in the tax/spending agenda of their respective local governments by persuading the majority to select a different set of governors with a different agenda. But they can also effect change by voting with their feet — migrating to live under another government that offers a fiscal approach more to their liking.

In general, strong local governments are a good idea: they allow public policies to vary across a country and so correspond more closely to the preferences of local majorities and they avoid some of the diseconomies of scale that ensue when national governments provide services. Interjurisdictional competition renders local democracy more meaningful by keeping local governments on their toes. Admittedly, local governments may be assigned functions for which they are inefficiently small. Economists continue to debate these matters, but in general, the advocates of political decentralization have made advances over the last generation.[6]

Governments should not complicate the choice of off-reserve or on-reserve living.

For interjurisdictional competition to function effectively and for people to make efficient decisions about where they live, governments should not bias locational choices. Provincial health insurance provides a relevant example. In the initial years after introduction of universal health insurance in the 1960s, Canadians were eligible for benefits only in their province of residence. Not wanting health insurance to bias their mobility, Canadians demanded portability provisions, which in due course the provinces negotiated. In the 1984 *Canada Health Act*, interprovincial portability became one of the five "national principles" defining medicare.

Consider now the choice faced by Indians of living either on- or off-reserve. At present, nearly all federal treaty benefits accrue only to those on-reserve.[7] Among these benefits are exemption from taxation of income earned on-reserve, free housing, and access to social assistance under more relaxed rules than those of off-

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5 See, for example, Inman and Rubinfeld's (1997) survey article on the political economy of federalism. A classic writer on this subject is Charles Tiebout (1956).

6 Many development agencies, such as the World Bank, stress the importance of empowering local governments. Among the most prolific Canadian contributors to this development literature is Richard Bird. An example of his analysis, written for a Latin American audience, is to be found at Bird (ca. 2000).

7 A few treaty benefits are accessible to all Indians regardless of their location, for example, so-called noninsured health benefits (such as dental care). Whether Indian tax exemption is a treaty benefit is unclear. As a provision of the *Indian Act*, the exemption from taxation of on-reserve income earned by Indians is open to amendment by Parliament. Indian leaders, however, view this exemption as a treaty benefit, and would regard any legislative restriction as a justiciable treaty violation. Recent court decisions have intensified the controversy by extending tax exemption; early in 2002, for example, the Federal Court found that no Indian residing within Treaty Eight boundaries is liable to payment of tax on income earned either on- or off-reserve (*Benoît v. Attorney General of Alberta*). The decision is currently under appeal.

reserve provincial welfare programs.[8] The implicit rationale for the status quo is that treaty benefits are an entitlement of band governments, intended to support them in the provision of services at acceptable levels. The system for allocating transfers to individual bands is complex, but it essentially follows the same principle as Ottawa's equalization payments to have-not provinces: the poorer the reserve, the larger the per-capita transfer.

By paying treaty benefits almost exclusively through band governments, Indian Affairs has introduced a large locational bias into the lives of aboriginal Canadians. Given that Indian Affairs transfers are to some extent related to band population, migration off-reserve — Indians voting with their feet — will in time have an impact on a band's budget. But in the short run, the fiscal costs of migration are borne by the migrating Indians, who lose access to most benefits.

Canadians have agreed that the payment of treaty benefits is appropriate compensation to Indians for loss of their lands. However, the case for allocating benefits to band councils, which essentially precludes benefits for off-reserve Indians, is weak. In the past, when the great majority of registered Indians lived on-reserve, the locational bias did not loom large. But by the 1990s more than two of five registered Indians had chosen to live off-reserve.[9]

The solution seems obvious: pay treaty benefits, or at least a sizeable fraction of them, to individual Indians regardless of place of residence. That is precisely what Jean Allard argues in his proposal for "updated treaty money," as discussed in the next section.

The solution is to pay treaty benefits to individual Indians, regardless of their place of residence.

Own-Source Taxation

Governments often perform poorly when not constrained by taxpayers debating how and how much to tax themselves. This problem applies to both authoritarian governments that exercise an arbitrary power to tax and to junior-level governments with no need to tax because their revenues derive from transfers made by a senior government. When a government must rely on own-source taxation — in other words, when those under its purview must agree to tax themselves for the public services they receive — there exist highly desirable incentives for efficiency and popular participation. The need to raise the requisite taxes means that political leaders are more likely to assess the benefits of incremental services against the costs of incremental taxation. The need to pay the taxes imposed means that local citizens are more inclined to participate in debating the issues at hand.

Introducing own-source taxation to Indian bands does not require new legislation. While section 87 of the *Indian Act* exempts on-reserve Indians from federal and provincial taxation, section 83 explicitly enables councils to tax their members. "The original legislative intentions underlying section 83," Jon Kesselman (2000, 1533) summarizes, "were for aboriginal governments to impose

8 Over the 1990s, the welfare dependency rate averaged above 40 percent among the on-reserve population. This was approximately five times the analogous rate over the decade among the nonaboriginal Canadian population (Richards 2001).

9 In 2000, 58 percent of registered Indians lived on-reserve; 42 percent, off-reserve (Canada 2001).

taxes on their own members as a way of developing institutions and practices of self-governance based on a municipal model."[10] However, while the concept of band councils levying on-reserve taxes has been part of federal legislation since the late nineteenth century, in practice, the extent of revenues so raised has been minor (about $30 million annually in the late 1990s, less than one percent of band budgets [Kesselman 2000, 1528]).

"Updated Treaty Money"

What relevance have the above ideas to band governance? Band members are often poor and band tax bases usually too small to enable much own-source taxation. The answer, argues Allard (2002), is a great deal. The necessary policy innovation is "updated treaty money."

The so-called numbered treaties, which cover bands from western Ontario to the Northwest Territories, all contain provision for payment of $5 annually to every man, woman and child belonging to the signatory band. A chief receives $25 annually, and three of his subordinates $15. In nineteenth-century rural Canada, these were nontrivial benefits. Allard proposes to "update" them so they again become meaningful. He proposes that the historical $5 become $5,000 dollars, paid annually to every Indian regardless of residence, with much of the funds required being diverted from present federal transfers to band councils.[11]

Updating treaty money in this way would make two contributions to the governance agenda: it would lower the present locational bias imposed on individual Indians, and it would enable the introduction of own-source taxation on reserves, which presently have very limited fiscal capacity.

Introducing any variant of updated treaty money would entail controversial changes to the current system of "fiscal federalism" as practiced by Indian Affairs. These changes can be summarized as follows:

- *Definition and imposition of a credible funding formula for individual bands.* If updated treaty money is not to affect the total amount (individual plus collective) of transfer money available to a band, Indian Affairs must define a credible band funding formula — and oblige band councils to respect it. This is not an easy task, given the history of band auditing in Canada. Ideally, band councillors would entertain a reasoned debate over what portion of the updated treaty money to channel to the council as a form of own-source taxation and what portion to leave as income for individuals to spend as they wish. If a council voted to tax the treaty money at 100 percent, there would be no change in its budget; any rate less than 100 percent would reduce the

10 Kesselman's article deals with a dimension of on-reserve taxation that has proved politically controversial and philosophically troubling, namely the taxation by bands of the property of non-members leasing band lands. Although there may be provisions for expressing an advisory opinion, non-member taxpayers have no right to representation in the councils of the tax-levying authority.

11 Allard is proposing an increase far greater than that needed to account for inflation. Based on inflation as measured by the consumer price index, $5 in, say, 1882 could buy roughly what $200 could in 2002.

budget, requiring spending cuts. Indian Affairs could serve as the band tax collection agency (as the Canadian Customs and Revenue Agency does for the provinces), deducting at source whatever portion of treaty money the band council voted to levy as tax.

- *Payment of treaty money to off-reserve Indians.* Payment of treaty money to off-reserve Indians would increase Indian Affairs' expenditures. If off-reserve migration ensues, the net cost to Ottawa of the program will become higher than the accompanying table suggests. Off-reserve migration would also reduce band budgets to the extent of the foregone tax on treaty money.
- *Interaction of treaty money and eligibility for social assistance.* Presumably, band councils would take the (post-tax) treaty money received by an on-reserve family into account when calculating its eligibility for welfare. The provinces would do likewise for those living off-reserve. Treaty money would lower the need for welfare, but among those who do receive this assistance, it may do little to change present locational incentives. And, since treaty money would lower the aggregate benefits paid to off-reserve Indians via provincial welfare, it would constitute an indirect transfer from Ottawa to provincial governments.[12]

For band taxes imposed on individual treaty money to have a meaningful impact, they must be a significant fraction of band finances. On the other hand, the purpose of this reform is to redistribute benefits paid to Indians, not increase them. Payment of benefits to off-reserve Indians would increase aggregate spending and must be offset somehow. The extent of offsets defines the amount that can be disbursed in off-reserve treaty benefits and hence an upper bound on the updated treaty money payable to individual Indians.

Table 1 illustrates the annual gross and net expenditures for Ottawa that would result from two variants.[13] Allard's proposal is probably too generous; it would exacerbate already undesirable levels of welfare dependency and, to maintain overall budget neutrality, require a reduction in other aboriginal programs of $1.4 billion. A more modest variant would pay $2,500 to each adult Indian, a diversion of about a fifth of present transfers to bands ($786 million out of a total of $4.1 billion). Given the present distribution of off-reserve to on-reserve residence, the second variant would entail additional federal spending of $569 million annually. This increase in benefits could probably be offset without major program disruption.[14]

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12 At present, perhaps a third of off-reserve Indians receive provincial social assistance. A relevant precedent here is increased payments over the 1990s made by Ottawa to low-income families with children under the National Child Benefit System. Most provinces included these benefits when calculating social assistance payable and accordingly lowered their aggregate welfare payments. The provinces undertook to devote the savings to alternate programs of benefit to low-income families.

13 The calculations rely on data prepared by the Department of Indian Affairs (Canada 2001). The Department recorded 675,500 registered Indians in 2000; of these, 330,900 were adults, age 20 or over.

14 I estimate that savings of $500 million could be achieved through a combination of three options: First, Indian Affairs, which was spared the belt tightening imposed on most line ministries in the...

Table 1: *Annual Expenditures for Various "Updated Treaty Money" Proposals, 2000*

	On-Reserve	Off-Reserve Net Expenditure	Gross Expenditure (Total of On- and Off-reserve Expenditure)
		($ millions)	
Allard Proposal ($5,000 paid annually to all Indians)	1,960	1,420	3,380
Modified Proposal ($2,500 paid annually to all adult Indians)	786	569	1,355

Conclusion

Since 1969, most Canadians have come to understand that aboriginal governments should be taken seriously as part of the Canadian political fabric. Many Indians want to live a more traditional style of life, as is possible on a well-run reserve; others prefer to live off-reserve. Paying attention to some economic ideas could empower individual Indians by lowering the fiscal bias in their choice of where to live and by giving those who do live on-reserve more effective tools for holding their chiefs and councils to account.

Note 14 - continued

...mid-1990s, could probably prune its departmental overhead. Second, Health Canada could reduce noninsured health benefits for off-reserve Indians. Finally, treaty money paid to off-reserve Indians could be treated as taxable income.

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